Module 5

Financial Management & Analysis I

IN THIS MODULE

This module aims to provide directors with basic knowledge and skills in financial management plus the ability to analyze the financial position and operational performance needed for quality monitoring and planning.

SPECIFIC OBJECTIVES:

After completing Module 5 on Financial Management and Analysis I, Directors will be able to:

1. Understand the financial management cycle
2. Widen their knowledge of basic accounting and finance terminology used in financial statements
3. Be aware of the responsibility of the Board and CEO related to financial management
4. Develop basic skills in analyzing financial statements for monitoring and planning using the PEARLS Monitoring System
5. Raise their awareness of the importance of budgets and the role of the Board and CEO

CONTENT:

1. Financial Management Cycle
   - Documenting Past Performance
   - Analyzing Past Performance
   - Predicting Future Performance
2. PEARLS Monitoring Tool
3. What to expect of the Auditors

FORMAT:

Pre-Course Work:

The participants will have the following pre-course work:

- Reading the PEARLS Monitoring Tool Manual
- Benchmarking CDF Credit Union using the PEARLS Monitoring Tool

FYI

The facilitator is encouraged to insert "Ice Breakers" in between topics. The facilitator should be very sensitive regarding the level of participation. Participants should be highly motivated at all times.

At the Workshop:

The participant will be able to practice effective financial management skills through practical exercises and participate in discussion regarding method of learning. The course will also provide opportunities for learning from the experience of other participants, through discussion groups and exchange of ideas. The participant will be able to understand the role of finance in strategy formulation and implementation; the available tools for measuring performance, assessing risk, increasing the credit union value and creating strategic alignment.

Credit Union Project:

The participants are required to carry out an objective assessment of their credit union's operational performance using PEARLS or the prudential standards used in their country. The participants are required to discuss the results of the analysis to the Board with corresponding strategies to reach the standards. A written report of the financial analysis with recommendations for improvement (strategies) will be submitted to the Registrar of the CUDCC.

MINIMUM TIME:

4 hours (240 minutes)

LIST OF HAND OUTS AND MATERIALS

PowerPoint:

1. Financial Analysis and Management 1
2. PEARLS Monitoring Tool

Exercises:

1. Quiz: Review of the Basic Finance and Accounting Terms the Board Needs to Know
2. Case Study of CDF Credit Union
3. PEARLS Diagnosis and Recommendations

Equipment/Materials:

1. LCD
2. White Board or Flip Chart or Black Board
4. White Board Marker or Permanent Marker or Chalk
5. Manila Papers or its equivalent (wide)
6. Meta Cards
7. Hand outs/Reference Materials

SESSION GUIDELINE

1. Preliminary Activity - 10 Minutes

Explain that the Module on Financial Management and Analysis I provide directors with basic knowledge and skills in financial management and the ability to analyze the financial position and operational performance needed for quality monitoring and planning.

Exercise 1: Ask participants:

- **What in particular would you like to learn within the scope of this module?**

Ask the participants to spend two or three minutes jotting down some topics or questions they hope to see addressed in the next four hours. After completing, request them to spend five minutes discussing their answers with other participants seated on the same table. Then, discuss the summarized answers of the group (per table) while the facilitator is jotting the answers on the flip chart. The facilitator explains which topics or questions are possible within the scope of this module.

Present the module objectives in power point or through an overhead projector, whatever is available.

At the end of module 5, Directors will be able to:

a. Understand the financial management cycle
b. Widen knowledge of basic accounting and finance terminology used in financial statements
c. Be aware of the responsibility of the Board and CEO related to financial management
d. Raise awareness of the importance of audit and what to expect of external auditors
e. Develop basic skills in analyzing financial statements for monitoring and planning using the PEARLS Monitoring System

Explain that to achieve the above objectives the following topics will be tackled:

1. Financial Management Cycle

    - Documenting Past Performance
    - Analyzing Past Performance
    - Predicting Future Performance

2. What to expect of the Auditors
3. The PEARLS Monitoring Tool

Emphasize that this training adopts different participatory methods such as small group discussion, informal discussion, individual and group exercises, brainstorming and lecture is also used for some technical subjects. In the small group discussion, each team is required to select a team leader and secretary/reporter on a rotation basis. Enjoin them to cooperate and observe proper time management.

2. Financial Management Cycle: Documenting Past Performance- 90 minutes

Continue with the PowerPoint Presentation on Financial Management Analysis 1, presenting the slide on the Financial Management Cycle (slide 5) where the responsibilities of the Board emanate:

- Documenting past performance
- Analyzing past performance
- Predicting future performance

Exercise 2: Ask the participants this question:

- What are the responsibilities of the Board with respect to the financial operation of the credit union?

Note to Facilitator

Group the participants into four or five teams. Participants should sit with their teams. This will contribute to positive group dynamics. The participants may be regrouped into different teams everyday to provide the opportunity for more interaction. Regrouping is advisable if modules are carried out separately.

Request participants to spend 5 minutes writing down their answers individually, then discussing their answers with the group for another 5 minutes. Ask each table to share their answers while you are recording them on a flip chart. Present Slide 6 summarizing the Board responsibilities with reference to participants' answers you summarized on the flip chart:

- Protect members assets
- Ensure quality service
- Consider member needs

Proceed to slide 6 explaining that the achievement of Board's responsibilities to members and public is pictured in the following financial statements:

- Income Statement or Statement of Operations
- Balance Sheet or Statement of Financial Condition
- Statement of Cash Flow

Exercise 3: Review of the Basic Finance and Accounting Terms the Board Needs to Know

The exercise will ensure that you are speaking the same language as the participants. Discuss the answers to each item. This will take about 20 minutes including some explanation of the answers then display the answers in a PowerPoint.

Note: Completing the course on Accounting for Non-Accountants is a prerequisite to this module. The national federation is offering the course.

Exercise 4: After completing exercise 3, proceed to slide 9 and ask the participants:

- What activities are involved in this cycle of financial management?

Elicit the following answers from the participants. Distribute one Meta card to each participant and ask them to write down their opinions on the card. Collect the cards and post them on the board/wall. Group the common answers then show slide 9 explaining each point while referring to the answers of participants written in the Meta cards. Following are the activities:

- Authority
- Execution of transactions
- Accounting
- Reporting
- Internal and External Audit

Explain that the financial statements of the credit union is a reflection of the outcomes of the above activities.

Exercise 5: Again, ask the participants this question: What the Board asserts (affirms or declares) on the financial statements of the credit union?

This might be difficult for the participants, but the facilitator should be able to give a hint. Explain that this is what the Board wants to tell to their members and the public about the financial statements of the credit union. Ask the participants to discuss this in the group for 10 minutes and list down the answers. Give them 5 Meta cards and ask them to paste them on the board after 10 minutes.

Show Slides 10-16. Explain the meaning of the Credit Union Board assertion to the financial statements and ask participants to give examples.

- **Existence or Occurrence-**whether the assets, obligations and equities included in the Balance Sheet actually existed on the Balance Sheet date.

  Example: The Manager of ABC Credit Union instructed the accountant to charge Education and Training expense to the income statement and recognize the expense as Accrued Expense or Liability. The Balance Sheet and Income Statement has an expense and liability account not actually incurred. This is a violation of accounting principles.

- **Completeness-**whether all transactions and accounts that transpired during the accounting period should be included in the financial statements

  Example: To improve the bottom line and meet the target, the Manager of ABC Credit Union instructed not to record an unpaid communication expense billed on December 31, 2003.

- **Valuation or allocation-**whether all assets, liabilities, equity, income and expenses have been included at appropriate amounts

  Example: Failure to provide sufficient allowance for doubtful loans is a violation of the assertion on "valuation and allocation." The Board must ensure that correct valuation of assets like Loans Receivable. Allowance for doubtful loans should follow the standards or benchmark used in the industry.

- **Rights and obligations-**whether all assets are the rights and liabilities are the obligations of the credit union at a given time

  Example: An asset presented in the Balance Sheet should have legitimacy. Thus, sufficient legal documents establish the legitimacy of ownership.

- **Presentation and disclosures-**whether components of the financial statements are properly combined or separated, described and disclosed

  Example: The credit union changed its accounting policy on expense and income recognition from Cash to Accrual Method. The credit union has to disclose this change in the financial statements through the Footnotes,

Exercise 6: In the group, ask the participants (Slide 17): What is the responsibility of the Board and CEO to ensure that the credit union meets assertions on the financial statements? Give 10 minutes to discuss the assignment and a group report written on Meta Card. Use the following headings on the white board: **BOARD & CEO**. Ask the participants to post their answers under each of the headings.

Show Slide 18 on the Board and CEO Level playing field:

Board	CEO
• Develop accounting policy following international accounting standards • Develop internal control policy • Monitor and assess risk	• Adopt and develop accounting system and procedures based on policy • Develop internal control system and procedures based on policy • Monthly reporting to the Board

Exercise 7: In the group, ask the participants: What are the areas under the Accounting Policy and Accounting Systems and Procedures? Give Meta Cards and ask to post on the Board under these Headings: Accounting Policy and Accounting System.

Show Slide 19 on Policy vs. Systems and Procedures

Board	CEO
• Accounting principles and standards to be used • Reporting period • Type of reporting	• Accounting documents or source of original entries • Books of accounts • General and Subsidiary ledgers • Chart of accounts • Reporting Formats and time period

Exercise 8: Explain that internal control is the environment within which the accounting system is operating. This exercise will give an understanding on the framework of internal control. Ask participants to identify the internal control: Policy areas, systems, and procedures:

Use the Meta Card in this exercise. Ask the participants to post the answers on the Board under these headings: Internal Control Policy and Internal Control Systems and Procedures. Present Slide 20.

<table>
<tr><th colspan="2">Internal Control</th></tr>
<tr><th>Policy (framework)</th><th>Systems and Procedures</th></tr>
<tr><td>• Adequate separation of duties
• Proper authorization of transactions and activities
• Adequate documents and records
• Independent check on performance</td><td>• Detailed systems and procedures on transactions such as:
- Receipts
- Disbursement
- Non-cash transactions
- Loan approval
- Purchase of equipment
- Others</td></tr>
</table>

Understand what the auditor does:

Explain using slides 21 to 23

The financial statements include the external auditor’s opinion. In many cases, people are confused about the role of the independent auditor. People often think that it is the auditor’s job to verify that the financial statements are accurate. However, this is not the case. In their capacity as objective outsiders, auditors evaluate whether the financial statements present fairly the credit union’s financial position and results of operations and its cash flows. They do this in several ways, including sending out letters to members, suppliers and other entities and asking them to confirm the financial information that is recorded on the credit union books. Auditors also test internal control procedures. The credit union establishes internal controls to minimize the possibility of error and fraud. The auditors use different audit techniques to reach an opinion on the credit union financial statements. The auditors are attesting the Board and Management assertions on the financial statements and use evidence to satisfy their examination through:

- Physical examination
- Confirmation
- Documentation
- Observation
- Inquiries of the client
- Reperformance
- Analytical procedures

Following are the types of opinions the auditor can render on the credit union financial statements:

1. Unqualified opinion – the report an auditor issues when all auditing conditions have been met, no significant misstatements have been discovered and left uncorrected, and it is the auditor's opinion that the financial statements are fairly stated in accordance with generally accepted accounting principles.

2. Qualified opinion – a report issued when the auditor believes that the overall financial statements are fairly stated but that either the scope of the audit was limited or the financial data indicated a failure to follow generally accepted accounting principles.

3. Adverse opinion – a report issued when the auditor believes the financial statements are so materially misstated or misleading as a whole that they do not present fairly the entity's financial position or the results of its operations and cash flows in conformity with generally accepted accounting principles

4. Disclaimer of opinion – a report issued when the auditor has not been able to become satisfied that the overall financial statements are fairly presented.

3. Financial Management Cycle: Analyzing Past Performance – 90 minutes

Importance of Ratios:

Explain that financial statements are more than just number-crunching. They are important management tools. However, to get the full value of the statements, you will need a little number crunching. Simply reading the numbers on the statements is not enough and to understand what the numbers are saying, you need to put them in cotext.

Exercise 8: Request the participants to form a "Bee Group" (3 participants in a group). Ask this question: Give at least three reasons why ratios are useful?

First participants answer the question individually for five minutes using Meta cards. For another five minutes, the participants discuss the answers to the "Bee group", and come up with one group answer. Stick the answers on the white board.

Note to Facilitator

Ensure that the participants have completed the assignment on the CDF Credit Union Case Study. You will be discussing the interpretation of PEARLS ratios of CDF rather than the calculation of ratios. However, participants can also ask for some clarifications.

Present slide 26 to 28. Highlight the same point written by the participants on the Meta cards.

- Standardize numbers; facilitate comparisons
- Used to highlight weaknesses and strengths
- Provide basis for decision making
- Ratio analysis allows managers and others to monitor performance against norms or other standards.
- It is an Early Warning Device that alerts the management to danger

Ask the participants what must be the limitations of the ratio analysis. Solicit some answers from the participants. Engage them in a small brainstorming. Show slide 29 to 30 on the limitations of ratio analysis:

- Different operating and accounting practices distort comparisons
- Sometimes it is hard to tell if a ratio is *"good"* or *"bad."*
- Difficult to tell whether the credit union is, on balance, in a strong or weak position
- "Average" performance not necessarily good
- Seasonal factors can distort ratios
- "Window dressing" techniques can make statements and ratios look better.

PEARLS Monitoring Tools:

Present the PowerPoint on PEARLS Ratios. This presentation contains the key ratios of PEARLS. Discuss the interpretation of the ratios of CDF Credit Union and the strategies needed to achieve the goals.

Note to Facilitator

It is assumed that the participants have read the PEARLS Monitoring Tool monograph distributed as pre-course assignment. This module would then review the tool and apply it in the CDF Credit Union. This module intends to develop the skills of the Board in analyzing and identifying appropriate strategies to achieve the goals of PEARLS.

Explain Slide 2-6 of the Financial Analysis PowerPoint:

Slide 2:

PEARLS is the international prudential standards for credit unions developed by the World Council of Credit Unions. In the October 2002 PEARLS Monitoring System monograph, the tool has a total of 49 quantitative ratios.

Slide 3:

- **Executive Management Tool** – It is designed as a management tool that goes beyond the simple identification of problems. It helps managers find meaningful solutions to serious institutional deficiencies. For example, the PEARLS system is capable of identifying a credit union with a weak capital base, and can identify the probable causes (e.g., insufficient gross income, excessive operating expenses, or high delinquency losses). Use of the system permits managers to quickly and accurately pinpoint troubled areas, and to make the necessary adjustments before problems become serious. In essence, PEARLS is an "early warning system" that generates invaluable management information.

- **Standardized Evaluation Ratios and Formulas** - The use of standardized financial ratios and formulas eliminates the diverse criteria used by credit unions to evaluate their operations. It also creates a universal financial language that everyone can speak and understand. One result can be enhanced communication that facilitates a greater understanding of the main concepts along with a commitment to achieve greater uniformity in the quality and strength of each individual credit union, by improving deficient operational areas.

- **Objective, Comparative Rankings** - The combined use of the standardized accounting system and the PEARLS performance indicators produces a completely new type of information: comparative credit union rankings. Historically, it was impossible to compare one credit union with another due to the diverse criteria and reporting formats that existed. The standardization of financial information eliminates diversity and provides an effective tool for comparing credit union performance on a national basis. One particularly important aspect of the PEARLS comparative rankings is its objectivity. No qualitative or subjective indicators are included in the rankings. This differs from the U.S. CAMEL system that gives management a numerical rating based upon the examiner's overall subjective judgment. By avoiding subjective assessments, it is possible to present objective reports to the credit unions that are substantiated by financial information taken from their balance sheets. The objective ranking system permits open discussion of problems with Boards of Directors and management. It is particularly useful in situations where a credit union is at the bottom of the ranking scale. No time is lost debating different points of view, and leadership can become more focused in seeking solutions to the problems affecting their institutions.

- **Facilitate Supervisory Control -** In addition to its usefulness as a management tool, the PEARLS system provides the framework for a supervisory unit at the National Federation. National Associations can use the financial ratios generated by PEARLS to conduct quarterly or monthly analyses of all key areas of credit union operations. These evaluations are invaluable for spotting trends and detecting areas of concern among the affiliates. With the standardization of the key financial ratios, all interested parties are looking at the same thing--what is important to the examiner is also important to the credit union manager. The introduction of the PEARLS evaluation system can change the role of National Association examiners to that of verifying the financial information used in calculating the ratios. If errors are found, they are relatively easy to correct and often provide management with further insight to their operations. The Federation examiners should play a key role in preserving the credibility of the financial information and ratios reported by the credit unions.

Slide 4:

Considering the economic and legislative diversity of many Asian countries, cooperative/credit union regulators adopted PEARLS and CAMELS. This has been the trend since 2002. The cooperative regulators in Asia developed the following prudential standards composed of qualitative and quantitative indicators:

- COOP-PESOS in Philippines
- GOLD-PEARLS in Bangladesh
- COOP-RUPEES in Sri Lanka
- GLARES in Hong Kong
- HIMAL-PEARLS in Nepal

Emphasize that PEARLS can suite any credit union environment. For developing credit unions operating in volatile economic and political environment, the most important aspect emphasized by PEARLS is the growth ratios.

Slide 4:

Benchmarking is comparing your own procedures or performance to that of the very best and analyzing the reasons for the performance difference. Thus, PEARLS ratios are the best practices in credit union operating performance. A credit union benchmarking operations using PEARLS and adopting strategies to achieve the goals is moving towards world-class performance by employing best practices.

As a pre-course assignment, participants have started or completed working on the analysis of CDF Credit Union. Discuss the key ratios of PEARLS using the PowerPoint presentation. Encourage participants to ask questions and clarification of the ratios. Then ask them to work in a group assuming that they are in a Board meeting and the Manager submitted the PEARLS ratio analysis of their credit union. The group will fill in the Diagnosis and strategies to achieve the Goals of PEARLS. The following table is the ratio analysis with corresponding recommendations to achieve the goals of PEARLS:

	PEARLS Ratios Indicators	**Goals**	**Ratio**	**Diagnosis**	**Strategies to Achieve the Goals**
P1	Allowance for Loan Losses / Delinq. >12 Mo. *37,187/1,098,459 X 100*	100%	3.39%	***Inadequate Protection:*** *Inflated asset values and fictitious earnings. If the credit union is not anxious to recognize loan losses, and much less, to charge them off against earnings, it will lead to widespread abuse of the principles of safety and soundness. Reported net income is overstated, asset values are inflated, provision for losses are inadequate, and member savings are not adequately protected. In this case, the credit union is not being fair to their depositors whose first concern is the safety of their hard earned savings.*	*1. Increase growth spread (R8) by means of adjustments to the savings and loan interest rates. This will allow an increase in the allocations (R10) without affecting the earnings.* *2. Reduce portfolio delinquency by a) better credit analysis and b) effective collection.* *3. Write off loans over 12 month's delinquency on a quarterly basis.* *4. Monthly adjustments of the allocation for bad loans to keep a balance equal to 35% of total delinquency and 100% of loans over 12 months delinquent.* *5. Let the funds from special recoveries of written-off loans be used to strengthen the allocations for current loans.* *6. Include within the loan interest rates the historical cost of uncollectible loans.*
P2	Net Allowance for Loan Losses / Delinq. 1-12 Mo.	35%	0		
	EFFECTIVE FINANCIAL STRUCTURE				
E1	Net Loans / Total Assets *5,375,078 – (80,904 +1,073,885 X 35%) – (1,073,885 + 24,574)/ 18,090,067 X 100*	**70 - 80%**	**19.8%**	*The credit union has a significant exposure to non-earning assets. This has direct effect to the ability of the credit union to meet the credit needs of its members.*	*1. Liquidate non-earning assets.* *2. Minimize idle and less profitable liquidity.*
E2	Liquid Assets / Total Assets *646,484 + 1,000 + 30,000/ 18,090,067 X 100*	**Max 20%**	**3.8%**	*Liquidity being too low is not a good sign of operation. The credit union is unable to service the withdrawal of depositors, meet the loan demand, and pay for the operating expenses of the credit union.*	*1. Set the optimal level of this indicator in terms of excess cash equivalents after subtracting there from the cash requirements* *2. Liquidate non-earning assets and invest them in earning assets.*

	PEARLS Ratios Indicators	Goals	Ratio	Diagnosis	Strategies to Achieve the Goals
E3	Financial Investments / Total Assets *1,005,448/ 18,090,067 X 100*	**Max. 10%**	**5.6%**		
E5	Savings Deposits / Total Assets *4,614,610 + 4,096,525 / 18,090,067 X 100*	**70 - 80%**	**48 %**	*Savings is the source of growth. Perhaps, the members are putting their money to shares in order to borrow but the credit union would have . Are you still using the share capital as multiplier for loans? If yes, you would have problem in meeting the loan demand of your members. Since savings is not growing, you might opt for external borrowing, a practice being discouraged by PEARLS.*	*The priority is to liquidate the non-earning assets and reduce delinquency. It is dangerous if the credit union is mobilizing savings. Currently, the savings is at risk.*
E6	External Credit / Total Assets *2,483,170 / 18,090,067 X 100*	**Max. 5%**	**13.7%**	*It is not healthy practice. If the external borrowing is used to finance the acquisition of non-earning assets, the credit union is decreasing its profitability because of the additional cost charged to operating expenses. This is also a burden to members if the cost of financing is added to the services.*	*The priority is to liquidate the non-earning assets and reduce delinquency.*
E7	Member Share Capital / Total Assets *4,861,301 / 18,090,067 X 100*	**10-20%**	**26.87**	*Perhaps, members are putting their money to shares in order to borrow.*	1. *Use capacity based lending not share leveraging.* 2. *Strengthen and integrate financial counseling in the role of the frontline staff and loan officers.*
E8	Institutional Capital / Total Assets *242,648 / 18,090,067 X 100*	**Min. 10%**	**1.7%**	*The credit union does not have sufficient capital to finance non-earning assets. If the credit union did not achieve A3, the credit union is using more expensive deposit savings, member shares or external borrowing to finance non-earning assets. The credit union also has a weak capital base to absorb losses from loan delinquency, as a last resort.*	1. *Achieve an efficient financial structure (E1-E7) with optimized yields (R1-R2), minimizing non-earning assets (A2) and idle liquidity (L1 & L2).* 2. *Monitor and minimize overhead.* 3. *Reduce delinquency (A1) and as a result thereof reduce the need to build provisions.* 4. *Capitalize undistributed reserve-all net earning generated by the credit union.*

	PEARLS Ratios Indicators	Goals	Ratio	Diagnosis	Strategies to Achieve the Goals
					5. *Review and evaluate allocations for bad loans and transfer excess to undistributed reserve.* 6. *Transfer the balance from other reserves to undistributed reserve prior to annual close-out.* 7. *Capitalize profits and bonuses from other investments directly to the undistributed reserve (shares and interests)* 8. *Purge shares and deposit accounts of inactive members according to an established schedule and transfer the balances to undistributed reserves.*
E9	Net Institutional Capital/Total Assets *242,648 – (80,904 +1,073,885 X 35%) – (1,073,885 + 24,574)/ 18,090,067 X 100*	**Same as E8**	**10.5 %**	*Same as E8*	*Same as E8*
			ASSETS QUALITY		
A1	Total Delinquency / Total Loan Portfolio *80,904 +2,147,770 + 24,574 /5,375,078 X 100*	**Less Than 5%**	**42%**	*Delinquency is the most important measurement of institutional weakness. Delinquency is affecting all other key areas of credit union operation. It reduces the credibility of the credit union. The depositors' savings is at risk. The credit union would easily lose the trust of the depositors and public. The following are the consequences of high delinquency:* 1. *Low liquidity* 2. *Rationing loans to members* 3. *Low profit* 4. *Low institutional capital* 5. *Inability to pay competitive salaries to employees*	1. *Assign collection responsibility to one person* 2. *Initiate administrative collection starting with the first unpaid installment.* 3. *Undertake extrajudicial and judicial collections in a timely fashion, including effective follow-up.* 4. *Establish surcharge charges for delinquency at no less than 3% a month.* 5. *Increase the contract interest rate by 3 percentage points on delinquent loans.* 6. *Award prompt payment of loan installments by means of drawings.* 7. *Improve credit analysis using credit scoring tool.*

	PEARLS Ratios Indicators	Goals	Ratio	Diagnosis	Strategies to Achieve the Goals
					8. *Do not use lending management instruments irrationally like renewals and extensions.* 9. *Require lawyers to provide a monthly report on the progress in legal collections.* 10. *Restrict credit until the delinquency problems have been solved.*
A2	Non-Earning Assets / Total Assets *(1,000 + 30,000 + 928,970 + 6,085 + 373,347 +20,465 + 140,625 +6,929,194 + 1,009,676 + 1,411,113 + 133,279 + 115,940) / 18,090,067 X 100*	**Less Than 5%**	**61.35**	*The higher the ratio, the more difficult it is to generate sufficient earnings. Where credit unions are in dire need of improving their poor physical image, the non-earning asset ratio can increase in a short run. However, big building is not important. What is important is a professional office sufficient to carry out the operation.* *The credit union also purchased lot intended for subdivision. This is beyond their mandate and specialization. Today's real estate business is too competitive.*	1. *Evaluate leasing alternatives against purchase or construction of fixed assets. Banking strategy.* 2. *Establish depreciation and amortization policies based on the actual useful life of the asset and based on the applicable accounting standards.* 3. *Make a rapid realization of special assets.* 4. *Undertake an aggressive campaign to collect non-earning accounts receivable, including an analysis of age and amounts, establishing a policy for write-offs.* 5. *Define an accounting policy for fixed assets and write-offs.*
	RATES OF RETURN AND COSTS				
R9	Operating Expenses / Average Assets 229,197-15,000 /(18,090,067+ 15,000,000/2)/ .25[1]	**5%**	**5.2%**	*High administrative cost is the reason why many credit unions are not profitable. Please refer to the strategies.*	1. *Prepare the budget conservatively and make quarterly adjustments thereto in terms of the growth in assets observed in the preceding quarter and target ratio.* 2. *Convert increase in personnel, leadership and other expenses related to human resources into variables against fulfillment of goals, starting from the core budget.*

[1] *This ratio is an annual assessment. In this case, the ratio is divided by 25% to get the annualized ratio. January to March financial statement represents 25% of the year. This is only a rough estimate of the ratio.*

	PEARLS Ratios Indicators	Goals	Ratio	Diagnosis	Strategies to Achieve the Goals
					3. *Review administrative structure to determine the need for each position and to readjust salaries.* 4. *Establish personnel incentives on meeting combined goals.* 5. *Eliminate superfluous expenses and establish discipline in expenses of leadership and employees.* 6. *Use the budget as a tool for the authorization of expenses, making sure that there are resources to do so. The fact that a budget allocation exists does not imply there are resources to spend.* 7. *Apply the principle of assigning expenses and insurance, office supplies and tools etc., to the period in which they are used.* 8. *Appraisal and collection expenses should be charged to the member.*
R12	Net Income / Average Assets *7,854 /(18,090,067+ 15,000,000/2)/0.25*	**Linked to E9**			
			LIQUIDITY		
L1	Liquid Assets-Short Term Payables / Member Deposits *(646,484 + 1,000 + 30,000) – (5,704 – 373 – 175,445 – 131,203 – 3,367 – 76,960 – 49,180)/ 8,711,135 X 100*	**Min. 15%**	**2.7%**	*Probable problems:* 1. *Difficulties to meet immediate withdrawal of deposits* 2. *Rationing loan services to members* 3. *Difficulties in meeting administrative expenses including salaries of staff*	1. *Adjust the credit union's liquidity levels on a daily basis.* 2. *Before approving new loans, ensure that the credit union can meet minimum liquidity levels.* 3. *Prepare a cash flow statement on a weekly basis and compare forecasts with actual figures.*
L2	Liquid Assets-Short Term Payables / Member Deposits *(646,484 + 1,000 + 30,000)/ 8,711,135 X 100*	**10%**	**7.8%**	*Same as L1*	

	PEARLS Ratios Indicators	Goals	Ratio	Diagnosis	Strategies to Achieve the Goals
				SIGNS OF GROWTH	
S10	Growth in Membership *(2,354-2,130)/2,130 x 100*	**>12%**	**10.5**	*See recommendations*	1. *Make requirements for the admission of new members more flexible.* 2. *Use market studies, principally demographic segmentation of your market to guide promotion efforts.* 3. *Make more flexible and readapt the idea of membership to convert the 'saving users' into 'real members.'* 4. *Organize investigation panels with 'non-members' to determine the causes for low membership growth.* 5. *Incorporate the Business Plan, the goal of real membership growth, indicating the effort necessary to achieve this.* 6. *Review on a quarterly basis the range of ages of the Youth Program to convert young people who have reached the age of 18 into full members.* 7. *Develop specific promotions to attract members.* 8. *Work in a personalized manner on the 'opinion leaders' of the communities to attract membership groups.*
S11	Growth in Total Assets *(18,090,067-15,000,000)/15,000,000 x 100*	**> inflation rate**	**20.6**	*Growth in total assets is one of the most important ratios. Many of the formulas used in PEARLS ratios include total assets as the key denominator. Strong consistent growth in total assets improves many of the PEARLS ratios. By comparing the growth in total assets to other key areas, it is possible to detect changes in the balance sheet structure that could have a positive or negative impact on earnings. The ideal goal for all credit unions is to achieve real positive growth (i.e. net growth after subtracting for inflation) each year.*	1. *Use parameter of minimum growth.* 2. *Use the savings deposit as the main source of growth and prepare a good marketing program to attract more savings.* 3. *Optimize the credit union's financial structure.* 4. *Pay market rates on assets, provided it contributes to the gross spread.* 5. *Reduce non-earning assets.*

After the exercise, distribute the Hand Out on PEARLS Diagnosis and Recommendations. This document will help the directors to understand the meaning of each ratio and the choice of strategies to improve the ratios.

Ask the participants: What are the lessons gained in the exercise: PEARLS analysis?

Expect that participants would share many ideas at this point and list them down on the flip chart. Highlight that the most important value of the ratio analysis is being able to identify weaknesses and areas of improvement. This will aid the Board in directing the future of the credit union.

In the case of CDF Credit Union, the “Goal” areas are very visible. Ask the participants what goal area has to be the focus of CDF Credit Union. Following are the probable answers (Slide 36-Financial Management & Analysis PP):

- Savings
- Membership
- Delinquency
- Loans

This will be your link to the next sub-topic on Predicting the Future Performance.

4. Financial Management Cycle: Predicting Future Performance – 30 minutes

Explain that budget is not something coming from the sky and ask participants to share their budget process. Allocate 10 minutes to exchange ideas on the budget process.

Proceed to slides 37 to 42.

Slide 38

Explain that budget is managing your credit union’s future financial performance. Therefore, it is a control tool that can help Board and CEO analyze the difference between the expected business performance and actual results.

Slide 39 to 41

Group Activity: Working in a group, ask the participants these questions:

- Identify the Board and CEO level playing field in budgeting.
- What kind of budget has to be prepared?

Give them 10 minutes to discuss. The groups report their answers and summarize them on the flip chart.

Then, explain the slide on the level playing field of Board and CEO:

Board	CEO
• Develop policy on budgeting • Set priorities on the budget based on goals • Recommend to the General Assembly the approval of the budget • Monitor	• Implement the policy • Prepare budget with assumptions based on the priorities • Report to the Boards the Actual vs. Budget with variance analysis of key numbers or accounts

The following are the budgets:

1. Projected Income Statement
2. Projected Balance Sheet
3. Projected Statement of Cash Flow

5. Credit Union Project

During this module, Directors gained skills in financial management and analysis. They are now ready to commence their fifth credit union project to be submitted for assessment to the Registrar of the Credit Union Directors Competency Program.

The participants are required to carry out an objective assessment of their credit union's operational performance using PEARLS or the prudential standards in the country. The participants are required to discuss the result of the analysis to the Board with corresponding strategies to reach the standards. A written report of the financial analysis with recommendations for improvement (strategies) will be submitted to the Registrar of the CUDCC.

The participants are also required to prepare a presentation kit including brief notes and a report to the Board of Directors.

6. Conclusion

Wrap up the session recalling to the trainees what you told them. Summarize that this module provided Directors with knowledge and skills in financial management, analyzing the financial position and operational performance needed for quality monitoring and planning.

Present again the power point on training objectives to recap what the module aimed at in the development of Directors:

At the end of module 5, Directors will be able to:

a. Understand the financial management cycle
b. Widen knowledge on the basic accounting and finance terminology used in the financial statements
c. Be aware of the responsibility of the Board and CEO related to financial management
d. Raise awareness regarding the importance of audit and what to expect of external auditors
e. Develop basic skills in analyzing financial statements for monitoring and planning using the PEARLS Monitoring System

f. Increase awareness regarding the importance of, and process of budgeting

Explain that the following topics were discussed to achieve the objectives of the module:

1. Financial Management Cycle

    - Documenting Past Performance
    - Analyzing Past Performance
    - Predicting Future Performance

2. What to expect of the Auditors
3. PEARLS Monitoring Tool

Encourage participants to clarify if there are grey areas on the topics shared and discussed in the last 4 hours (more or less). Conclude that the board of director's role in financial management is very important to the achievement of the goals and objectives of the credit union.

Lastly, thank the participants for their active participation and wish them good luck in facing the challenges of their respective credit unions through regular and meaningful analysis of the financial condition and operational performance.

Present the prepared closing activity.

Exercise 3:

Review of the Basic Finance and Accounting Terms the Board Needs to Know

INSTRUCTION: Choose the correct answer. You have 15 minutes to answer the questions.

1. This statement lists assets, liabilities and owners' equity as at a certain period.

    a. Balance Sheet
    b. Income Statement
    c. Statement of Cash Flow
    d. Financial Statements

2. This statement deducts expenses from revenue to arrive at net income, otherwise known as profit.

    a. Balance Sheet
    b. Income Statement
    c. Statement of Cash Flow
    d. Financial Statements

3. This statement shows the sources, uses and availability of money to the business.

    a. Balance Sheet
    b. Income Statement
    c. Statement of Cash Flow
    d. Financial Statements

4. What do you call the economic resources owned by a credit union?

    a. Assets
    b. Liabilities
    c. Share Capital
    d. General Reserve Fund

5. What do you call the economic resources a credit union owes?

    a. Assets
    b. Liabilities
    c. Share Capital
    d. General Reserve Fund

6. Current assets in the Balance Sheet represent:

    a. Asset item having a life or one year or less, or the normal operating cycle of the business
    b. Asset item having more than one year life
    c. Asset item that can be converted into cash
    d. All of the above

7. Current liabilities in the Balance Sheet represent:

   a. Obligation payable for more than one year
   b. Obligation with no maturity date
   c. Obligation payable within one year or the normal operating cycle of the business
   d. None of the above

8. This system spreads the cost of tangible assets, such as office equipment, over the useful life the asset.

   a. Depreciation
   b. Amortization
   c. Demutualization
   d. Capitalization

9. A system that spreads the cost of an intangible asset, such as patent, over the useful life of the asset is called:

   a. Depreciation
   b. Amortization
   c. Demutualization
   d. Capitalization

10. A plan of the credit union and all the methods and measures used to monitor assets, prevent fraud, minimize errors, verify the correctness and reliability of accounting data, promote operational efficiency, and ensure that established managerial policies are followed.

    a. Internal Check
    b. Internal Control
    c. Accounting Check
    d. Management Control

11. This accounting method records transactions only when money is received or paid.

    a. Accrual method
    b. Modified Accrual method
    c. Cash basis method
    d. None of the above

12. This accounting method records transactions when the transaction is complete, whether or not the transaction has been paid for or not.

    a. Accrual method
    b. Modified Accrual method
    c. Cash basis method
    d. None of the above

13. This is a system where revenue is recognized when it becomes available or received. Expenditures are typically recognized in the period in which the liability is incurred.

    a. Accrual method
    b. Modified Accrual method
    c. Cash basis method
    d. None of the above

14. The expected collectiblility of loans receivable after deducting from the gross loans receivable the allowance for doubtful loans. The Board is accountable to ensure that this amount is presented correctly in the Balance Sheet.

    a. Net proceeds
    b. Net realizable value
    c. Net income
    d. Net present value

15. These are the rules and guidelines of accounting. This is the basis of recording the credit union assets, revenue and expenses.

    a. Generally Accepted Accounting Principles
    b. Chart of Accounts
    c. Accounting Procedures
    d. Accounting Policies

16. It is a judgment of a Certified Public/Chartered Accountant in the Audit Report that **"except for"** something, the financial statements fairly present the financial position and operating results of the credit union.

    a. Qualified Opinion
    b. Unqualified Opinion
    c. Disqualified Opinion
    d. Qualitative Opinion

17. A written confirmation from management to the external auditor about the fairness of various financial statement elements. The purpose of the letter is to emphasize that the financial statements are management's representations, and thus management has the primary responsibility for their accuracy.

    a. Auditor Letter
    b. Management Representation Letter
    c. Engagement Letter
    d. Compliance Letter

18. Under the PEARLS Ratios, Non-Earning Assets are the resources owned by the credit union that do not give return or income. This has to be minimized to 5% or less of the total assets. What are those assets:

    a. Cash on Hand, Non-Interest Bearing Monetary Checking Account, Accounts Receivable, Fixed Assets (Land, Building, equipment etc.), Prepaid expenses
    b. Fixed Assets (Land, Building, equipment etc.), Prepaid expenses
    c. Cash on Hand, Non-Interest Bearing Monetary Checking Account, Accounts Receivable, Fixed Assets (Building, equipment etc.), Prepaid expenses
    d. Cash on Hand, Non-Interest Bearing Monetary Checking Account, Fixed Assets (Building, equipment etc.), Prepaid expenses

19. This is a list of ledger account names and numbers arranged in the order in which they customarily appear in the financial statements. This serves as useful source for recording the transactions of the credit union in a systematic manner.

    a. Accounting Policy
    b. Chart of Accounts
    c. General Ledger
    d. Subsidiary Ledger

20. This is an expense paid in a lump sum in one accounting period but not completely used or consumed. Example is a rental paid for the months of December 2003 to January 2004 for US$ 1,000. At the end of the year 2003, half of the rental paid is not consumed. This is called:

    a. Rent Expense
    b. Accrued Expense
    c. Prepaid Expense
    d. None of the above

Answer Guide to Exercise 2

Review of the Basic Finance and Accounting Terms the Board Needs to Know

1.	a	2.	b
3.	c	4.	a
5.	b	6.	a
7.	c	8.	a
9.	b	10.	b
11.	c	12.	a
13.	b	14.	b
15.	a	16.	a
17.	b	18.	a
19.	b	20.	c

PEARLS Diagnosis and Recommendations

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
PROTECTION				
P1	Allowance for Loan Losses for Delinquent Loans of more than 12 months	100%	**Meets the Standard:** Congratulations! Please refer to your delinquency ratio. If the delinquency ratio is high, protection on losses is not the solution. Delinquency ratio should be decreased to standard of less than or equal to 5% of the total delinquent loan portfolio. **Inadequate Protection:** Inflated asset values and fictitious earnings. If your credit union is not anxious to recognize loan losses, and much less, to charge them off against earnings, it will lead to widespread abuse of the principles of safety and soundness. Reported net income is overstated, asset values are inflated, provision for losses are inadequate, and member savings are not adequately protected. In this case, you are not being fair to your depositors whose first concern is the safety of their hard earned savings.	1. Increase growth spread (R8) by means of adjustments to the savings and loan interest rates. This will allow an increase in the allocations (R10) without affecting the earnings. 2. Reduce portfolio delinquency by a) better credit analysis and b) effective collection. 3. Write off loans over 12 month's delinquency on a quarterly basis. 4. Monthly adjustments of the allocation for bad loans to keep a balance equal to 35% of total delinquency and 100% of loans over 12 months delinquent. 5. Transfer the excess allocations for reconstruction loans to the allocations for current loans. 6. Let the funds from special recoveries of written-off loans be used to strengthen the allocations for current loans. 7. Include within the loan interest rates the historical cost of uncollectible loans.
P2	Allowance for Loan Losses for Delinquent Loans of more than 12 months	35%	Same as above	Same as above

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
PROTECTION				
P6	Solvency	>110	Measure of the protection that the credit union has for members savings and shares in the event of liquidation of the credit union's assets and liabilities. **Meets the Standard:** Congratulations! **Does not Meet the Standard:** This is the true value of members' shares and deposits. Your credit union has significant asset quality problems, negative earnings trends or high credit or interest-rate risk exposure expected to cause the credit union to become critically undercapitalized. These factors are sufficient to jeopardize the solvency of the credit union. If these continue to happen, your credit union might have no access to capital sources either deposit from members or from your central finance facility. Everybody's concern is the protection and safety of their deposits.	1. Reduce your risks assets. 2. If risk asset is the delinquent loan portfolio, please follow the recommendation under P1 and P2

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Effective Financial Structure				
E1	Net Loans to Total Assets	70-80%	Credit unions are encouraged to maximize productive assets as the means of achieving sufficient earnings. Since the loan portfolio is the most profitable asset of the credit union, it is recommended maintaining 70-80% of the total assets in the loan portfolio. Savings mobilized by the credit union should be invested back to the community in the form of loans. **Meets the Standard:** Congratulations! **Does not Meet the Standard:** ***When the ratio is more than 80% of total assets****:* Your credit union have over exposure on loans and your liquidity will suffer. You may anticipate problems in meeting the demand for withdrawal of savings. This is also an indication that you might have a significant amount of delinquent loans which are not moving, or you are still using the share capital/savings as a multiplier in granting loans. ***When the ratio is below 70% of the total assets:*** Your credit union might have over exposure to non-earning assets or maintains excess liquidity or your loan products are not meeting the real needs of your members. This is not a healthy balance because the use of your capital is not being maximized.	1. Set the optimal level of this indicator in terms of cash equivalents (E2) and the yield of this investment (R1) with regard to other investment alternatives. 2. Readapt lending policies and standards in the following areas: competitive and worthwhile interest rates on savings; amounts to be granted; terms and purpose; leverage; new investment projects; and security. 3. Speed up loan processing. 4. Liquidate non-earning assets. 5. Minimize idle and less profitable liquidity.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Effective Financial Structure				
E2	Liquid Investments to Total Assets	Maximum 20%	Serves as liquidity to meet the withdrawals of members' savings and loans granting for members. **Meets the Standard:** Congratulations! However, to ensure the sufficiency of liquidity, the credit union should prepare a projected cash flow to ensure that cash requirement is met without delay. **Does not Meet the Standard:** Over liquidity is not a good sign. The use of members' savings is not properly maximized. Your profit margin is narrowing if the cash and cash equivalent are generating interest lower than the interest charged on loans.	3. Set the optimal level of this indicator in terms of excess cash equivalents after subtracting there from the cash requirements and the return on of investment against other investment alternatives. 4. Liquidate non-earning assets and invest them in earning assets. 5. Minimize idle and less profitable liquidity by means of following suggestions: • Manage savings deposit bank accounts with automatic transfer to checking accounts. • When interest-earning money market accounts appear on the market, transfer checking accounts to this type of account. • Negotiate overdrafts in banks up to the maximum cash balances for the purpose of nullifying the effect of idle cash equivalents.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Effective Financial Structure				
E3	Financial Investments to Total Assets	Maximum 10%	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Your credit union is tightening your liquidity position and decreasing your service to your members if you have significant sum in long-term financial investment.	1. Set the optimal level of this indicator in terms of excess cash equivalents after subtracting there from the cash requirements and the return on of investment against other investment alternatives. 2. Liquidate non-earning assets and invest them in earning assets. 3. Minimize idle and less profitable liquidity.
E4	Non-Financial Investments to Total Assets	0%	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Your credit union is tightening your liquidity position and decreasing your service to your members if you have significant sum in non-financial investment. The main business of the credit union is financial services. Investing in any business (ex. Consumer, operating a school) other than financial services is a violation of the credit union mandate. This would mean depriving your members and depositors to gain access to affordable financial services and access to their deposits whenever they need them.	1. Set the optimal level of this indicator in terms of excess cash equivalents after subtracting there from the cash requirements and the return on of investment against other investment alternatives. 2. Close the business. 3. Fund the business from other sources. Do not use the savings and shares of the members that are intended for financial services. 4. Treat this as a subsidiary of your credit union with separate investment **<u>not</u>** coming from the shares and savings of the members. 5. A separate recording, reporting and monitoring should be maintained for this business.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Effective Financial Structure				
E5	Savings Deposits to Total Assets	70-80%	**Meets the Standard:** Congratulations! A healthy percentage of deposit savings indicates that your credit union has developed effective marketing programs and is well on its way to achieving financial independence. It also indicates that members are no longer "saving" in order to borrow money, but are instead saving because of the competitive rates offered. Above all, this is an indication that the credit union has inculcated the habit of thrift to its members. ***Note**: if the savings is used as multiplier for loans, then the savings is not considered as "real" savings. The ratio is measuring the "real" savings of the members.* **Does not Meet the Standard:** Savings is the source of growth. Perhaps, your members are putting their money to shares in order to borrow. Are you still using the share capital as multiplier for loans? If yes, you would have problem in meeting the loan demand of your members. Since savings is not growing, you might opt for external borrowing, a practice being discouraged by PEARLS.	1. Pay attractive interest rates on deposits but taking care that they are always below the loan rates charged. 2. Set savings rates within the market average and do not attempt to pay more than the market, unless necessary to attract bank savers. 3. Implement supplementary services such as: fund transfers; access to other services; timely seasonal promotions. 4. Create a generalized policy of opening savings accounts with loans granted to members in those cases in which they do not exist. 5. Make entrance requirements more flexible for saving members. 6. Be creative and design new figures for savings i.e savings for special purposes; family savings 7. Improve institutional image so that it will be professional and sound. 8. Promote savings protection mechanisms: insurance, cash reserves and others that might arise.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Effective Financial Structure				
E6	External Borrowing to Total Assets	Maximum 5%	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** It is not healthy practice. If the external borrowing is used to finance the acquisition of non-earning assets, the credit union is decreasing its profitability because of the additional cost charged to operating expenses. This is also a burden to members if the cost of financing is added to the services. If the external borrowing is used to fund the services to members, most often, interest rate of external credit is higher than the savings interest rate. The cost of fund is higher. Further, the external creditor usually influences the decision of the credit union if the external credit is significant.	1. Go into external borrowing only for the following reasons: • Emergency credit from the Central Finance facility of the Apex organization to meet liquidity requirement • Utilization of external lines of credit to finance long-term projects. 2. Intensify your savings mobilization. 3. Borrowing should not be funding the acquisition of non-earning assets such as land and building.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Effective Financial Structure				
E7	Member Share Capital to Total Assets	10-20%	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Perhaps, your members are putting their money to shares in order to borrow. Are you still using the share capital as multiplier for loans? If yes, you would have problem in meeting the loan demand of your members. Delinquency is another problem since the loans are granted to members who do not have the capacity to pay. The policy on share leveraging will also give a wrong signal to members that they are entitled to loans according to X number of times of their shares. A share is not an investment. It is an entitlement of ownership and the benefits associated with it.	1. Use capacity based lending not share leveraging. 2. Strengthen and integrate financial counseling in the role of the frontline staff and loan officers.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Effective Financial Structure				
E8	Institutional Capital to Total Assets	Minimum 10%	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** The credit union does not have sufficient capital to finance non-earning assets. If the credit union did not achieve A3, the credit union is using more expensive deposit savings, member shares or external borrowing to finance non-earning assets. The credit union also has a weak capital base to absorb losses from loan delinquency, as a last resort.	1. Do not allow the percentage of institutional capital growth (S8) to be greater than the percentage of growth of total assets (S11). 2. Achieve an efficient financial structure (E1-E7) with optimized yields (R1-R2), minimizing non-earning assets (A2) and idle liquidity (L1 & L2). 3. Monitor and minimize overhead. 4. Reduce delinquency (A1) and as a result thereof reduce the need to build provisions. 5. Capitalize undistributed reserve-all net earning generated by the credit union. 6. Review and evaluate allocations for bad loans and transfer excess to undistributed reserve. 7. Transfer the balance from other reserves to undistributed reserve prior to annual close-out. 8. Review and evaluate the provisions accumulated and transfer the excess to the undistributed reserve. 9. Capitalize profits and bonuses from other investments directly to the undistributed reserve (shares and interests) 10. Purge shares and deposit accounts of inactive members according to an established schedule and transfer the balances to undistributed reserves.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Asset Quality				
E9	Net Institutional Capital to Total Assets	Minimum 10%	Same as E8	Same as E8
A1	Total Loan Delinquency to Gross Loan Portfolio	<=5%	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** The delinquency ratio is the most important measurement of institutional weakness. If delinquency is high, it usually affects all other key areas of credit union operations. Delinquency reduces the credibility of your credit union. The depositors' savings is at risk. The credit union would easily lose the trust of the depositors and public. The following are the consequences of high delinquency: 6. Low liquidity 7. Rationing loans to members 8. Low profit 9. Low institutional capital 10. Inability to pay competitive salaries to employees	1. Assign collection responsibility to one person 2. Initiate administrative collection starting with the first unpaid installment. 3. Undertake extrajudicial and judicial collections in a timely fashion, including effective follow-up. 4. Establish surcharge charges for delinquency at no less than 3% a month. 5. Increase the contract interest rate by 3 percentage points on delinquent loans. 6. Award prompt payment of loan installments by means of drawings. 7. Improve credit analysis using credit scoring tool. 8. Do not use lending management instruments irrationally like renewals and extensions. 9. Require lawyers to provide a monthly report on the progress in legal collections. 10. Restrict credit until the delinquency problems have been solved.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Asset Quality				
A2	Non-Earning Assets to Total Assets	<=5%	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** The higher the ratio, the more difficult it is to generate sufficient earnings. Where credit unions are in dire need of improving their poor physical image, the non-earning asset ratio can increase in a short run. However, big building is not important. What is important is a professional office sufficient to carry out your operation.	1. Evaluate leasing alternatives against purchase or construction of fixed assets. Banking strategy. 2. Establish depreciation and amortization policies based on the actual useful life of the asset and on the basis of the applicable accounting standards. 3. Make a rapid realization of special assets. 4. Undertake an aggressive campaign to collect non-earning accounts receivable, including an analysis of age and amounts, establishing a policy for write-offs. 5. Define an accounting policy for fixed assets and write-offs.
A3	Financing of Non-Earning Assets	>200%	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** While reducing the percentage of non-earning assets is important, the financing of those assets is just as important. Ideally, 100% of all non-earning assets should be financed by institutional capital or with liabilities that have no explicit financial cost. If your ratio is lower than 100%, it simply means that share capital and savings finance your non-earning assets. This would certainly reduce your profit since cost funds are used to finance assets that do not generate return.	Follow strategies on A2

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Rates of Return and Costs				
R1	Net Loan Income to Average Net Loan Portfolio	Entrepreneurial Rate	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Your credit union might have high delinquency rate.	1. Set different interest rates on loans, according to the following criteria: purpose; amount; term and risk 2. Write off delinquent loans with heavy surcharges for delinquency. 3. Charge a commission for processing for new loans. 4. Establish an aggressive collection program to lower delinquency.
R2	Total Liquid Investments Income to Average Liquid Investments	Market Rates	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Please refer to the strategies.	1. Monitor on a monthly basis the interest rate that banks are paying on deposits. Review investments in cash equivalents held by the credit union and make adjustments on the placement of these cash equivalents to optimize their return without sacrificing safety. 2. Minimize idle liquidity 3. Liquidate non-earning assets and invest them in earning assets
R3	Total Financial Investments Income to Average Financial Investments Income		**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Please refer to the strategies.	1. Monitor on a monthly basis the interest rate that finance companies are paying on deposits. Review investments made by the credit union and make monthly adjustments in the placements to optimize the return without sacrificing safety. 2. Minimize idle liquidity 3. Liquidate non-earning assets and invest them in earning assets

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Rates of Return and Costs				
R4	Total Non-Financial Investment Income to Average Non-Financial Investment	Greater than R1	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Please refer to the strategies.	1. Carefully review the return on non-financial investments, because the credit union should specialize in financial services. If the return is lower that the return on financial investments, measures should be taken to divest them and give up those less profitable sidelines. 2. If the return is higher, who the users and beneficiaries are of these investments should be analyzed. If the majority are non-members, a separate business should be chartered with a separate capitalization. Under this framework, the cooperative idea is not watered down by doing business with third parties.
R5	Total Interest Cost on Savings Deposits to Average Savings Deposits	Market Rates > Inflation	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** In many instances, a poor growth rate for savings deposit is linked to non-competitive interest rates. Please refer to the strategies.	1. Evaluate and modify the structure of the ranges of deposits in accordance with needs. 2. Differentiate savings interest rates on the different ranges to attract deposits in the most economical fashion. 3. Perform monthly surveys of banks and other competitors to ensure that the credit union's savings interest rates are competitive on the financial market. 4. Optimize the financial structure. 5. Reduce non-earning assets and reinvest them in productive asserts.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Rates of Return and Costs				
R6	Total Interest Cost on External Credit to Average External Credit	Market Rates	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Please refer to the strategies.	Refer to the strategies on E6
R7	Total Interest (Dividend) Cost on Shares to Average Member Shares	Market Rates >=R5	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Please refer to the strategies.	1. Differentiate savings interest rates on different ranges of shares to reward members who have large amounts of money "frozen and idle." 2. Seek a balance between the need to create institutional capital and pay a fair return on shares, taking into account that shares are a long-term investment and therefore, should earn a higher interest than short-term savings deposits. 3. Increase the yield on shares through the following improvements in the credit union's operating efficiency: Optimize the financial structure by lowering the percentage of shares to 10-120%; reduce non-earning assets and reinvest them in productive assets; control and reduce unnecessary overhead; control delinquency and recover a high percentage of written-off loans. 4. Increase loan interest rate at the same time leverage is released to maintain the same level of earnings. 5. If savings deposit rates are higher than the bank's, lower them to the level of the competition and raise rates on shares by the same percentage.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Rates of Return and Costs				
R8	Total Gross Income Margin to Average Total Assets	Variable – linked to R9, R11, R12	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Please refer to the strategies.	1. Optimize financial structure. 2. Optimize the return on that structure. 3. Reduce non-earning assets and reinvest them in productive assets. 4. Control delinquency and write off delinquent loans with heavy surcharges for delinquency. 5. Minimize idle liquidity.
R9	Total Operating Expenses to Average Total Assets	5%	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** High administrative cost is the reason why many credit unions are not profitable. Please refer to the strategies.	1. Prepare the budget conservatively and make quarterly adjustments thereto in terms of the growth in assets observed in the preceding quarter and target ratio. 2. Convert increase in personnel, leadership and other expenses related to human resources into variables against fulfillment of goals, starting from the core budget. 3. Review administrative structure to determine the need for each position and to readjust salaries. 4. Establish personnel incentives on meeting combined goals. 5. Eliminate superfluous expenses and establish discipline in expenses of leadership and employees. 6. Use the budget as a tool for the authorization of expenses, making sure that there are resources to do so. The fact that a budget allocation exists does not imply there are resources to spend.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Rates of Return and Costs				
				7. Apply the principle of assigning expenses and insurance, office supplies and tools etc., to the period in which they are used. 8. Appraisal and collection expenses should be charged to the member.
R10	Total Loan Loss Provision Expense to Average Total Assets	Dependent on Delinquent Loans	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Please refer to the strategies.	1. Lower delinquency 2. Create monthly allocations for bad loans and do not wait until the end of the fiscal year to establish reserves. 3. Be conservative in building provisions i.e. expect higher delinquency and establish higher allocations than what is necessary during the year so that at the end of the year the adjustment of the operating statement will be facilitated to eliminate unnecessary allocations and meet recommended financial disciplines. 4. Analyze gross spread on a monthly basis to ensure that there is sufficient financial income to create estimates.
R11	Non-Recurring Income or Expense to Average Total Assets		**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Please refer to the strategies.	

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Rates of Return and Costs				
R12	Net Income to Average Total Assets	Linked to E9	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Please refer to the strategies.	1. Increase net earnings through the following improvements in credit union operating efficiency: optimize financial structure; optimize return on the ideal structure; control and reduce unnecessary overhead; reduce non-earning assets and reinvest them in productive assets; control delinquency and reduce allocations for bad loans; recover a high percentage of written-off loans. 2. Encourage policy of generating stable and safe earnings. 3. If there are sufficient earnings, analyze the possibility on raising the interest rate on shares and/or paying bonus to key employees.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Liquidity				
L1	Net Liquidity Reserves to Savings Deposits	Minimum 15%	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Probable problems: 1. Difficulties to meet immediate withdrawal of deposits 2. Rationing loan services to members 3. Difficulties in meeting administrative expenses including salaries of staff	1. Adjust the credit union's liquidity levels on a daily basis. 2. Before approving new loans, ensure that the credit union can meet minimum liquidity levels. 3. Prepare a cash flow statement on a weekly basis and compare forecasts with actual figures.
L2	Liquidity Reserves to Savings Deposits	10%	**Same as above**	1. Strictly respect the obligation of maintaining a cash reserve of 10% of deposits in your Central Finance Facility and consider it as the first obligation to be paid. 2. Make adjustments at the end of each month in the cash reserve levels deposited to CFF.
L3	Non-Earning Liquid Assets to Total Assets	<1%	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Probable problems: • Exposure to unnecessary risk in case the credit union is keeping large amount of cash in the office • Idle and non-earning liquidity would lose the opportunity to earn	1. Establish maximum amounts to keep in cash and monetary deposits. 2. Adjust the credit union's liquidity levels on a daily basis. 3. Keep a daily account of deposit entries and withdrawals (by number and size) to become familiar with the community's seasonal trends. The information obtained will help to fine-tune the amount of necessary idle liquidity.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Signs of Growth				
S1	Growth in Loans to Members	Dependent on E1	The loan portfolio is the most important and profitable credit union asset. If growth in total loans keeps pace with growth in total assets, there is a good likelihood that profitability will be maintained. Conversely, if loan growth rates drop, this suggests that other, less profitable areas are growing more quickly.	1. Use parameter of minimum growth. 2. Follow strategies mentioned in E1
S2	Growth in Liquid Investments	Dependent on E2		Follow strategies in E2
S3	Growth in Financial Investments	Dependent on E3		Follow strategies in E3
S4	Growth in Non-Financial Investments	Dependent on E4		Follow strategies in E4
S5	Growth in Savings Deposits	Dependent on E5	With the new emphasis on savings mobilization, savings deposits are the new cornerstone of growth. The growth of total assets is dependent on the growth of savings. The rationale for maintaining aggressive marketing programs is that it stimulates growth in new savings deposits that in turn, affect the growth of other key areas.	1. Use parameter of economic growth 2. Follow strategies in E2

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Signs of Growth				
S6	Growth in External Credit	Dependent on E6		Follow strategies in E6
S7	Growth in Share Capital	Dependent on E7	Although member share savings are de-emphasized in PEARLS, newly established credit unions may maintain a dependence on shares for growth. If growth rates in this area are excessive, it usually signals an inability of the credit unions to adapt to the new system of promoting deposits over shares.	Follow strategies in E7
S8	Growth in Institutional Capital	Dependent on E8	Institutional capital growth is the best indicator of profitability within credit unions. Static or declining growth trends in institutional capital usually indicate a problem with earnings. If earnings are low, the credit union will have great difficulty in adding to institutional capital reserves. One of the indisputable signs of success of a robust credit union in transition is a sustained growth of institutional capital, usually greater than the growth of total assets.	Follow strategies in E8
S9	Growth Net Institutional Capital	Dependent on E9		Follow strategies in E9

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Signs of Growth				
S10	Growth in Membership	> 12%	**Meets the Standard:** Congratulations! **Does not Meet the Standard:** Refer to the strategies to increase growth.	1. Make requirements for the admission of new members more flexible. 2. Use market studies, principally demographic segmentation of your market to guide promotion efforts. 3. Make more flexible and readapt the idea of membership to convert the 'saving users' into 'real members.' 4. Organize investigation panels with 'non-members' to determine the causes for low membership growth. 5. Incorporate the Business Plan, the goal of real membership growth, indicating the effort necessary to achieve this. 6. Review on a quarterly basis the range of ages of the Youth Program to convert young people who have reached the age of 18 into full members. 7. Develop specific promotions to attract members. 8. Work in a personalized manner on the 'opinion leaders' of the communities to attract membership groups.

	Ratios	Goals	Interpretation and Diagnosis	Strategies to be followed to attain the goal
Signs of Growth				
S11	Growth in Total Assets	> Inflation	Growth in total assets is one of the most important ratios. Many of the formulas used in PEARLS ratios include total assets as the key denominator. Strong consistent growth in total assets improves many of the PEARLS ratios. By comparing the growth in total assets to other key areas, it is possible to detect changes in the balance sheet structure that could have a positive or negative impact on earnings. The ideal goal for all credit unions is to achieve real positive growth (i.e. net growth after subtracting for inflation) each year.	1. Use parameter of minimum growth. 2. Use the savings deposit as the main source of growth and prepare a good marketing program to attract more savings. 3. Optimize the credit union's financial structure. 4. Pay market rates on assets, provided it contributes to the gross spread. 5. Reduce non-earning assets.

CREDIT UNION PROJECT
FINANCIAL MANAGEMENT AND ANALYSIS 1

PROJECT DESCRIPTION:	
Carry out an objective assessment of credit union's operational performance using PEARLS or the prudential standards in the country. The assessment includes identifying problem areas in the operation that relates to broad policies and provide specific recommendations to overcoming the deficiencies in operation.	
PROJECT ACTIVITY	**EVIDENCE REQUIREMENTS (WHAT WE NEED TO SEE)**
• Prepare an analysis of the operational performance of the credit union using the prudential standards followed in the country.	Report of the Analysis covering: • Ratios of the credit union as against the standards • Identification of the problem areas • Recommended policy concerns to improve the operation • Strategies to reach the standards
• Discuss the result of the analysis to the Board and CEO	Attendance Sheet of the Workshop
• Prepare a Report to be submitted to the registrar of the CUDCC	Report on the Workshop with the following contents: • Ratios of the credit union as against the standards • Identification of the problem areas • Recommended policy concerns to improve the operation • Strategies to reach the standards • Action Plan

PRE COURSE 1
CDF CREDIT UNION PEARLS RATIO ANALYSIS

(CDF Credit Union Financial Statements is in the Excel File)

	PEARLS Ratios Indicators	Goals	Ratio	Diagnosis	Strategies to Achieve the Goals
P1	Allowance for Loan Losses / Delinq. >12 Mo.	100%			
P2	Net Allowance for Loan Losses / Delinq. 1-12 Mo.	35%			
				EFFECTIVE FINANCIAL STRUCTURE	
E1	Net Loans / Total Assets	**70 - 80%**			
E2	Liquid Assets / Total Assets	**Max 20%**			
E3	Financial Investments / Total Assets	**Max. 10%**			
E5	Savings Deposits / Total Assets	**70 - 80%**			
E6	External Credit / Total Assets	**Max. 5%**			
E7	Member Share Capital / Total Assets	**10-20%**			
E8	Institutional Capital / Total Assets	**Min. 10%**			
E9	Net Institutional Capital/Total Assets	**Same as E8**			

	PEARLS Ratios Indicators	Goals	Ratio	Diagnosis	Strategies to Achieve the Goals
			ASSETS QUALITY		
A1	Total Delinquency / Total Loan Portfolio	**Less Than 5%**			
A2	Non-Earning Assets / Total Assets	**Less Than 5%**			
			RATES OF RETURN AND COSTS		
R9	Operating Expenses / Average Assets	**5%**			
R12	Net Income / Average Assets	**Linked to E9**			
			LIQUIDITY		
L1	Liquid Assets-Short Term Payables / Member Deposits	**Min. 15%**			
L2	Liquid Assets/ Member Deposits	**10%**			
			SIGNS OF GROWTH		
S10	Growth in Membership	**>12%**			
S11	Growth in Total Assets	**> inflation rate**			

CDF Credit Union

STATEMENT OF FINANCIAL CONDITION

as of April 30, 2004 with comparative figures of March 31, 2010

	A	B	C	D
12	CODING		**Current Mo.**	**Previous Mo.**
13		**A S S E T S**		
14		**CURRENT ASSETS**		
15	101	Cash on Hand	-	-
16	102	Cash in Bank	646,484.00	1,392,315.51
17	103	Petty Cash Fund	1,000.00	1,000.00
18	104	Revolving Fund	30,000.00	30,000.00
19	112	Accounts Receivables	928,970.00	950,614.73
20	140	Short Term Investments	-	-
21	150	Loans Receivable Current	3,121,830.00	3,091,917.14
22	151	Loans Receivable Restructured	80,904.00	80,904.00
23	152	Loans Receivable Past Due	2,147,770.00	1,977,369.98
24	153	Loans Receivable Loans in Litigation	24,574.00	24,573.50
25		**Total Loans Receivables (Gross)**	**5,375,078.00**	**5,174,764.62**
26	154	Less: Allowance for Probable Losses on Loans	(37,187.00)	(32,187.38)
27		**Net Loans Outstanding**	**5,337,891.00**	**5,142,577.24**
28	161	Inventories	6,085.00	13,655.00
29	162	Other Receivables/Sales Contract	373,347.00	373,347.28
30	170	Unused Office Supplies	20,465.00	20,157.00
31	171	Prepaid Expenses	140,625.00	156,250.00
32		**TOTAL CURRENT ASSETS**	**7,484,867.00**	**8,079,916.76**
33		**LONG-TERM INVESTMENTS**		
34	182	Long Term Investments Cooperatives	1,005,448.00	950,497.91
35	184	Long Term Investments Govt Securities/Bonds	-	-
36	185	Long Term Investments Others(Subd. Lots & SFA)	6,929,194.00	6,909,568.42
37		**TOTAL LONG-TERM INVESTMENTS**	**7,934,642.00**	**7,860,066.33**
38		**PROPERTY AND EQUIPMENT**		
39	191	Land	1,009,676.00	1,009,675.72
40	192	Land Improvements		
41	193	Less: Accumulated Depreciation - Land Improvements		
42	196	Building-net	1,411,113.00	1,416,274.52
43	205	Furniture, Fixtures and Office Equipment	133,279.00	122,829.63
44	208	Transportation Equipment	115,940.00	115,940.34
45	210	Leasehold Rights and Improvements		
46		**TOTAL PROPERTY AND EQUIPMENT**	**2,670,008.00**	**2,664,720.21**

	A	B	C	D
8	**STATEMENT OF FINANCIAL CONDITION**			
9	***as of April 30, 2004 with comparative figures of March 31, 2010***			
10				
12	CODING		**Current Mo.**	**Previous Mo.**
47		**OTHER ASSETS**		
48	250	Organizational Costs	-	-
49	251	Computerization Costs		
50	252	Other Funds and Deposits	-	-
51	256	Due from Head Office/Branch/Subsidy	-	-
52	257	Assets Acquired in Settlement of Loans	-	-
53	258	Other Land	-	-
54	259	Other Building	-	-
55	260	Less: Accumulated Depreciation - Other Building	-	-
56	261	Miscellaneous Assets	550.00	550.00
57		**TOTAL OTHER ASSETS**	**550.00**	**550.00**
58				
59		**TOTAL ASSETS**	**18,090,067.00**	**18,605,253.30**
60				
64				
65				
66		**L I A B I L I T I E S**		
67		**CURRENT LIABILITIES**		
68	300	Savings Deposits	4,614,610.00	3,504,125.71
69	303	Time Deposits	4,096,525.00	5,197,018.54
70	304	Loans Payable - Short Term	2,483,170.00	2,916,704.49
71	308	SSS/ECC/Philhealth Premium Payable	5,704.00	4,063.50
72	309	Withholding Tax Payable	373.00	373.24
73	310	Accrued Expenses	175,445.00	221,802.11
74	311	Interest on Share Capital Payable/Paronage Refund Payable	131,203.00	131,203.26
75	312	SSS/Pag-IBIG Loan Payable	3,367.00	3,367.06
76	313	Due toCETF (Apex)	-	-
77	314	Unearned Income	76,960.00	76,960.19
78	316	Accounts Payable	49,180.00	45,680.00
79		**TOTAL CURRENT LIABILITIES**	**11,636,537.00**	**12,101,298.10**

	A	B	C	D
8		**STATEMENT OF FINANCIAL CONDITION**		
9		***as of April 30, 2004 with comparative figures of March 31, 2010***		
10				
12	CODING		**Current Mo.**	**Previous Mo.**
80				
81		**LONG-TERM LIABILITIES**		
84	322	Retirement Fund Payable	55,669.00	55,142.89
85	323	Other Long-Term Payable	-	-
86		**TOTAL LONG TERM LIABILITIES**	**55,669.00**	**55,142.89**
87				
88		**OTHER LIABILITIES**		
89	331	Deposits for Share Capital Subscription	-	-
90	332	Project Subsidy Fund Payable	-	-
91	333	Mutual Benefit Funds Payable	1,034,111.00	1,155,781.89
92	334	Due to Head Office/Branch/Subsidiary	-	-
93		**TOTAL OTHER LIABILITIES**	1,034,111.00	1,155,781.89
94				
95		**TOTAL LIABILITIES**	**12,726,317.00**	**13,312,222.88**
96				
97		**E Q U I T Y**		
98				
99		**Members' Equity**		
100		Common Share Capital - Authorized Share Capital ________Shares @ P_____ par value		
101	361	Subscribed Share Capital - Common		
102	362	Less: Subscription Receivable - Common		
103	363	Paid-Up Share Capital - Common	4,861,301.00	4,833,027.86
104	364	Treasury Shares - Common	189,812.00	189,811.87
105		Preferred Share Capital - Authorized Share Capital ______Shares @ P______ par value		
106	365	Subscribed Share Capital - Preferred		
107	366	Less: Subscription Receivable - Preferred		
108	367	Paid-up Share Capital - Preferred	-	-
109		Total Paid-Up Share Capital		
110	368	*Undivided Net Surplus (Loss)	7,854.00	3,208.93
111		**TOTAL MEMBERS' EQUITY**	**5,058,967.00**	**5,026,048.66**
114	381			
122		**STATUTORY FUNDS**		
123	391	Reserve Fund	242,648.00	204,846.03
124	392	Education and Training Fund (Local)	1,293.00	1,293.26
125	393	Optional Fund/Land & Bldg. Fund	60,842.00	60,842.47
126		**TOTAL STATUTORY FUNDS**	**304,783.00**	**266,981.76**
127				
128		**TOTAL EQUITY**	**5,363,750.00**	**5,293,030.42**
129				
130		**TOTAL LIABILITIES AND EQUITY**	**18,090,067.00**	**18,605,253.30**

CDF Credit Union

STATEMENT OF OPERATIONS

as of April 30, 2004 with comparative figures of March 31, 2010

	A	B	C	D
4				
5				
6	**CODING**		**Current Mo.**	**Previous Mo.**
7		**REVENUES:**		
8	401	Interest Income from Loans	244,333.00	146,194.04
9	405	Service Fees	56,939.31	32,775.31
10	406			-
11	407	Fines, Penalties and Surcharges	76,660.16	67,793.49
12	408	Membership Fees	1,170.00	950.00
13	409	Income / Interest from Investment	1,156.76	525.34
14	410	Miscellaneous Income	48,716.40	21,781.22
15				
16		**TOTAL REVENUES**	**428,975.63**	**270,019.40**
17				
18		**EXPENSES:**		
19		**Financing Costs:**		
20	501	Interest Expense on Deposits	159,003.94	92,229.55
21	502	Interest Expense on Borrowings	32,919.86	-
22	503	Other Charges on Borrowings		20,291.26
23		**TOTAL FINANCING COSTS**	**191,923.80**	**112,520.81**
24				
25		**ADMINISTRATIVE COSTS**		
26	516	Salaries and Wages	106,794.06	67,624.83
27	517	Employees' Benefits'	20,388.95	20,388.95
28	518	SSS/ECC/Philhealth, Pagibig Contributions	8,429.53	4,773.44
29	519	Retirement Benefit Expense		-
30	538	Officers' Honorarium and Allowances	6,047.78	4,647.78
31	539	Training/Seminars	1,270.00	100.00
32	540	Office Supplies	10,982.00	8,692.50
33	551	Power, Light andWater	13,298.94	8,306.19
34	552	Travel and Transportation	7,141.25	4,004.80
35	553	Insurance	9,235.82	9,235.82
36	554	Repairs and Maintenance	4,111.00	2,791.00
37	555	Rental		-
38	556	Taxes and Licenses	3,385.00	3,235.00
39	557	Professional Fees	7,000.00	-
40	558	Communication Expense	8,859.66	5,894.10
41	559	Representation Expense	340.00	130.00

	A	B	C	D
4				
5				
6	**CODING**		**Current Mo.**	**Previous Mo.**
42	560	General Assembly Meeting Expenses		-
43	561	Meetings and Conferences	1,886.50	1,502.50
44	562	Bank Charges		-
45	563	Collection Expense		-
46	564	Litigation Expense		-
47	565	Affiliation Fees		-
48	566	Social Services Expenses		-
49	567	Promotional Expenses	1,869.00	969.00
50	568	Periodicals, Magazines, Subscriptions		-
51	569	General Support Services		-
52	570	Members' Benefit Expenses		-
53	575	Miscellaneous Expense	3,158.25	1,993.75
54	576	Depreciation and Amortization		-
55	577	Amortization of Leasehold Rights and Improvements		-
56	578	Provision for Probable Losses on Loans	15,000.00	10,000.00
57		**TOTAL ADMINISTRATIVE COSTS**	**229,197.74**	**154,289.66**
58				
59	591	***ADD: Subsidized Project Expenses***		
60				
61		**TOTAL EXPENSES**	**421,121.54**	**266,810.47**
62				
63		**Net Surplus Before Project Subsidy**	**7,854.09**	**3,208.93**
64	590	Add: Project Subsidy	-	-
65		Net Surplus on Operations	7,854.09	3,208.93
66		Add(Deduct) Extraordinary Items		
67	592	Gain or Loss on Sale of Acquired Assets/ P & Equipt		
68	593	Gain or Loss on Investment	-	-
69				
70		**NET SURPLUS (FOR ALLOCATION)**	7,854.09	3,208.93
71				
72		*Reserve Fund - Minimum of 10% of Net Surplus*	-	-
73		*CETF - Maximum of 10% of Net Surplus*	-	-
74		*Due to CETF (APEX)*		
75		*Optional Fund - Maximum of 10% of Net Surplus*		
76		Patronage Refund Payable 30%	2,356.23	962.68
77		Interest on Share Capital Payable 70%	5,497.86	2,246.25
78		**T O T A L**	7,854.09	3,208.93
79	**Additonal information:**			
80	1. Fifty percent of Loans Receivable Past Due is 1-12 months delinquent and 50% over 12 months delinquent.			
81	2. Assets last year was 15,000,000			
82	3. Members last year was 2,130 and this year was 2,354.			

Financial Analysis

CUDCC

Module 5

What is Financial Standard?

- PEARLS is the international prudential standards for credit unions

- Developed by the World Council of Credit Unions

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Module 5

Important Features of PEARLS?

- Executive Management Tool
- Standardized Evaluation Ratios and Formulas
- Objective, Comparative Rankings
- Facilitate Supervisory Control

CUDCC

Module 5

What is the trend in Financial Standard?

Adoption of PEARLS and CAMEL in Asian Countries

- ***COOP-PESOS in Philippines***
- ***PEARLS-GOLD in Bangladesh***
- ***COOP-Rupees in Sri Lanka***
- ***GLARES in Hong Kong***

CUDCC

Module 5

CUDCC

Module 5

Best Practices Benchmarking:

A Road Map for moving towards

WORLD-CLASS

performance by employing best practices

The Power of PEARLS

Key Ratios

CUDCC

Module 5

P E A R L S

P	***Protection***
E	Effective Financial Structure
A	Asset Quality
R	Rate of Return & Cost
L	Liquidity
S	Signs of Growth

CUDCC

Module 5

CUDCC

Module 5

P1. Allowance for loan losses / Delinquency > 12 months

Purpose: Measure adequacy of loan loss allowance when compared to all delinquent loans over 12 months.

Formula:

$$\frac{\textit{Allowance for Loan Loss}}{\textit{Loan Balances of All Delinquent Loans} > 12 \textit{ Months}}$$

Goal: Protection against 100% of loans delinquent greater than 12 months.

P2. Net Allowance for Loan Losses / Delinquency From 1 to 12 Months

Purpose: Measure adequacy of net loan loss allowance when compared to all loans delinquent from 1 to 12 months.

Formula:

$$\frac{\textit{Allo. for Loan Loss for Loans Delinquent 1- 12 mos.}}{\textit{Balance of All Delinquent Loans Outstanding From 1-12 Mos.}}$$

Goal: Protection against 35% of loans delinquent from 1 to 12 months.

CUDCC

Module 5

CUDCC

Module 5

P E A R L S

P ***ction***

E — Effective Financial Structure

L — Liqu

S — Sig

Effective Financial Structure

ASSETS		LIABILITES & CAPITAL	
E 2	*Liquidity -maxi. 20%*	E5	*Deposits 70-80%*
E1	*Loans 70-80%*	E7	*Share Capital 10-20%*
A 2	*Non-Earning Assets -maxi. 5%*	E8 & 9	*Institutional Capital minimum of 10%*

CUDCC

Module 5

E1. Net Loans / Total Assets

Purpose: Measure percentage of total assets invested in the loan portfolio.

Formula:

$$\frac{\textit{Total gross loan portfolio --- Loan Loss Allow.}}{\textit{Total assets}}$$

Goal: Between 70 and 80% of total assets. Less than 50% of total assets changes the CU's role as a financial intermediary.

CUDCC

Module 5

E2. Liquid Investments / Total Assets

Purpose: Measure percentage of total assets invested in earning liquid assets.

Formula:

$$\frac{\textit{Total liquid investments}}{\textit{Total assets}}$$

Goal: Maximum 20%

E3. Financial Investments / Total Assets

Purpose: Measure percentage of total assets invested in financial investments.

Formula:

$$\frac{\textit{Total financial investments}}{\textit{Total assets}}$$

Goal: Maximum 10%

CUDCC

Module 5

E5. Member Savings Deposits / Total Assets

Purpose: Measure percentage of total assets financed by member savings deposits.

Formula:

$$\frac{\textit{Total member deposits}}{\textit{Total assets}}$$

Goal: Between 70 and 80%

CUDCC

Module 5

CUDCC

Module 5

E7. Member Shares / Total Assets

Purpose: Measure percentage of total assets financed by member shares.

Formula:

$$\frac{\textit{Total member shares}}{\textit{Total assets}}$$

Goal: 10-20%

E8. Total Institutional Capital / Total Assets

Purpose: Measure percentage of total assets financed by institutional capital.

Formula:

$$\frac{\textit{Total institutional capital}}{\textit{Total assets}}$$

Goal: Minimum 10%

CUDCC

Module 5

E9. Net Institutional Capital / Total Assets

Purpose: **Measure the real level of institutional capital after adjusting the allowances for delinquent loans to meet the standards of P1 & P2, and covering any other potential losses**

Formula:

$$\frac{\textit{((Institutional Cap. + Allo. For Bad Loans) - (Bal. Of loan outstanding delinquent >12 mos + Bal. Of loan del. 1 to12 mos. X .35) + Problem Assets)}}{\textit{Total assets}}$$

Goal: Minimum 10%

CUDCC

Module 5

P E A R L S

P ... *ection*

E ... Financial Structure

A ***Asset Quality***

Rat...

S ... Signs...

CUDCC

Module 5

A = Asset Quality

A1. Total Loan Delinquency / Total Gross Loan Portfolio

A2. Non-Earning Assets / Total Assets

A3. Zero Cost Funds / Non-Earning Assets

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Module 5

A = Asset Quality

- Asset Quality is the main variable that affects institutional profitability.
- Delinquency must be correctly measured and zealously pursued.
- Non-earning assets should be minimized.
- Savings, External Credit, or Shares should never be used to purchase Non-earning Assets.

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Module 5

A1. Total Delinquency / Gross Loan Portfolio

Purpose: Measure percentage of delinquency in loan portfolio using *Outstanding Delinquent Balances* **NOT** *Accumulated Delinquent Payments.*

Formula:

$$\frac{\textit{Sum of delinquent loan balances}}{\textit{Gross loan portfolio outstanding}}$$

Goal: Less than or equal to 5%

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Module 5

A2. Total Non-earning Assets / Total Assets

Purpose: Measure percentage of total assets that is not producing income.

Formula:

$$\frac{\textit{Total non-earning assets (total of building, furniture, land, prepaid expenses, office supplies inventory, cash on hand, cash in current account)}}{\textit{Total assets}}$$

Goal: *Less than 5% of total assets*

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Module 5

Examples Of Non-earning Assets

- Cash on hand
- Non-interest bearing monetary checking accounts
- Accounts receivable
- Assets in liquidation acquired in execution of a guarantee
- Fixed assets (land, buildings, furniture, etc.)
- Prepaid or deferred assets

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Module 5

A3. Net Zero Cost Capital + Liabilities w/o Interest / Non-earning Assets

Purpose: Measure percentage of non-earning assets financed with net institutional capital, transitory capital and liabilities without interest.

Formula:

$$\frac{\textit{(Liabilities w/o interest + transitory \& net institutional capital)}}{\textit{Total non-earning assets}}$$

Goal: Greater than or equal to 100%

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Module 5

P E A R L S

P *...tection*

E Effective Financial Structure

Asset...

R ***Rate of Return & Cost***

Sign...

CUDCC

Module 5

R9. Operating Expenses /Average Total Assets

Purpose: Measure cost to manage all assets.

Formula:

$$\frac{\textit{Total operating expenses, w/o loan loss provisions}}{\textit{[(Total assets year-end + last year-end) / 2]}}$$

Goal: 5 %

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Module 5

R12. Net Income/Average Total Assets

Purpose: To measure the adequacy of earnings and also, the capacity to build Institutional Capital.

$$\frac{\textit{Net Income}}{\textit{[(Total assets year-end + last year-end) / 2]}}$$

Goal: **Enough to attain the goal of E9**

P E A R L S

P ***Protection***

E Effective Financial Structure

Asset Quality

Rates

L ***Liquidity***

S Signs

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Module 5

L = Liquidity

L1. Liquid Assets – Short-term Payables / Total Savings Deposits

L2. Liquidity Reserve / Total Savings Deposits

L3. Non-Earning Liquid Assets (Cash on Hand)/Total Assets

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Module 5

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Module 5

L1. Liquid Assets --- Short-term Payables / Member Deposits

Purpose: Measure adequacy of liquid cash reserves to satisfy withdrawal requests, after paying all obligations of ≤ 30 days.

Formula:

$$\frac{\textit{(Bank deposit Earning.+Non-earning. liquid assets --- Total payables} \le \textit{30 days)}}{\textit{Total member savings deposits}}$$

Goal: Minimum 15%

L2. LIQUIDITY RESERVES / SAVINGS DEPOSITS

Purpose: To measure compliance with obligatory Central Bank, CFF, or Other Liquidity Reserve

Formula:

$$\frac{\textit{(Bank deposit Earning.+Non-earning. liquid assets}}{\textit{Total member savings deposits}}$$

Goal: **10%**

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Module 5

P E A R L S

P ***Protection***

E Effective Financial Structure

A Asset Quality

R Rate of Return

L Liquidity

S ***Signs of Growth***

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Module 5

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Module 5

S10. Growth in Membership

Purpose: Measure growth in membership from one year to the next

Formula:

$$\left[\left(\frac{\textit{\# of members for current year}}{\textit{\# of members at last year-end}}\right) - 1\right] * 100$$

Goal: >12%

S11. Growth in Total Assets

Purpose: Measure growth of total assets from one year to the next.

Formula:

$$\left[\left(\frac{\textit{Total assets for current year}}{\textit{Total assets for last year-end}}\right) - 1\right] * 100$$

Goal: Greater than the inflation rate

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Module 5

The Power of PEARLS

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Module 5

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Module 5

Financial Management and Analysis 1

At the end of module 5, Directors will be able to:

1. Understand the financial management cycle
2. Widen their knowledge of the basic accounting and finance terminology used in financial statements
3. Be aware of the responsibility of the Board and CEO related to financial management
4. Raise awareness of the importance of audit and what to expect of external auditors

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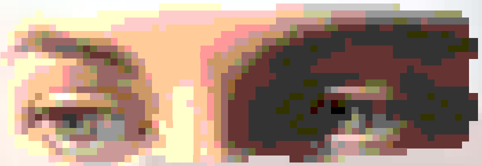
Module 5

At the end of module 5, Directors will be able to:

5. Develop basic skills in analyzing financial statements for monitoring and planning using the PEARLS Monitoring System

6. Increase awareness of the importance and process of budgeting

We will take a closer look at . . .



1. Financial Management Cycle
   - Documenting Past Performance
   - Analyzing Past Performance
   - Predicting Future Performance
2. What to expect of the Auditors
3. PEARLS Monitoring Tool

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Module 5

Financial Management Cycle

1

Documenting Past Performance

Income Statement
Balance Sheet
Statement of Cash Flow

Analyzing Past Performance

Ratio Analysis
Trend Analysis
Benchmarks-PEARLS, CAMEL

Predicting Future Performance

Cash Budget

Role of Board of Directors

- Ensure management is providing financial reports one week before meeting
- Reports compared with the plan - 2
- Find out reasons for the deviation
- Identify the weaknesses of the Board & management
- Provide direction to management
- Study the report
- Cross check
- Provide feedback to management - 2
- Approve
- Internal and external audit
- Submit to AGM
- Discuss the report

Financial Management Cycle

- What are the responsibilities of the Board in respect to the financial operation of the credit union?
  - Protect members assets
  - Ensure quality service
  - Consider member needs

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Module 5

Financial Management Cycle

- The financial operations of your credit union is clearly pictured in the following statements:

1. Income Statement
2. Balance Sheet
3. Statement of Cash Flow

- IFRS – International Financial Reporting Standards
- Indonesian Financial Reporting Standards

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Financial Management Cycle

We have a small quiz on the terminology of Financial Statements . . .

Review of the Basic Finance and Accounting Terms the Board Needs to Know

Instruction: ***Choose the correct answer. You have 15 minutes to answer the questions.***

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Module 5

Financial Management Cycle

Documenting Past Performance
Income Statement
Balance Sheet
Statement of Cash Flow

- What activities are involved in this cycle of financial management?
  - **Authority**
  - **Execution of transactions**
  - **Accounting**
  - **Recording transactions**
  - **Reporting**
  - **Internal Auditing**

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Financial Management Cycle

Documenting Past Performance
Income Statement
Balance Sheet
Statement of Cash Flow

- What the Board assert to members and public on their financial statements:

  - Existence or occurrence
  - Completeness
  - Valuation or allocation
  - Rights and obligations
  - Presentation and disclosure

Valuation of loans

Loans Outstanding	**Rs. 10,000**
Less: Provision for	
loan losses	**2,000**
Net Realizable Value	**Rs. 8,000**

Land value in balance sheet is purchase cost

Financial Management Cycle

- What is the meaning of **Management's Assertions**?

The Board Assert to the members & Public

- Existence or occurrence
- Completeness
- Valuation or allocation
- Rights and obligations
- Presentation and disclosure

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Answers to the quiz

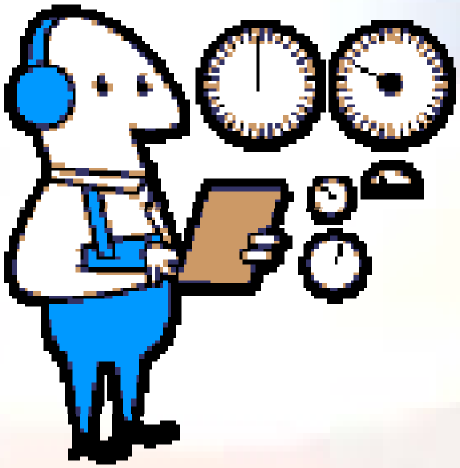
1	A	11	C
2	B	12	A
3	C	13	B
4	A	14	B
5	B	15	A
6	A	16	A
7	C	17	B
8	A	18	A
9	B	19	B
10	B	20	C

Financial Management Cycle

- **Existence or Occurrence**

Whether the assets, obligations and equities included in the Balance Sheet actually existed on the Balance Sheet date…

Can you give of example?



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Module 5

Financial Management Cycle

- **Completeness**

All transactions and accounts that transpired during the accounting period should be included in the Financial Statements.

Can you give an example?

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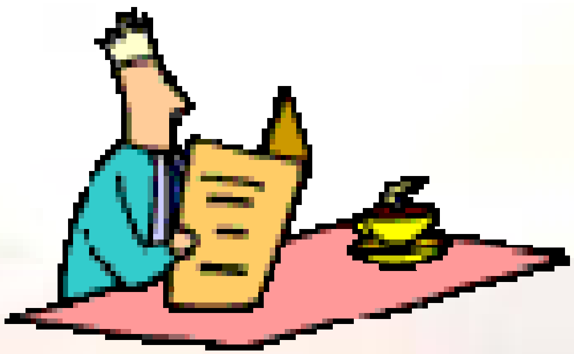
Module 5

Financial Management Cycle

- **Valuation and Allocation**

Whether all assets, liabilities, equity, income and expenses have been included at appropriate amounts.

***Example:* Loans should be presented in amount equivalent to Net Realizable Value**



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Module 5

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Financial Management Cycle

- **Rights and Obligation**

Whether all assets are the rights and liabilities are the obligations of the credit union at a given time.

Can you give an example?

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Module 5

Financial Management Cycle

- **Presentation and Disclosure**

Whether components of the financial statements are properly combined or separated, described and disclosed.

Can you give an example?

Financial Management Cycle

- What is the meaning of **<u>Management's Assertions</u>**?

The Board Assert to the members & Public

- Existence or occurrence
- Completeness
- Valuation or allocation
- Rights and obligations
- Presentation and disclosure

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Module 5

Financial Management Cycle

Documenting Past Performance
Income Statement
Balance Sheet
Statement of Cash Flow

Group activity . . .

- What are the Board & CEO responsibilities to meet the required assertions on the financial statements?

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Financial Management Cycle

- BOARD & CEO Level playing field

Board:

- Develop Accounting policy following international practices
- Develop Internal control policy
- Monitor and Risk Assessment

CEO:

- Adopt & develop accounting system & procedures based on policy
- Develop Internal control system & procedures based on policy
- Monthly reporting to the Board

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Financial Management Cycle

- What is accounting Policy vs Systems & Procedures ?

Policy	***Systems & Procedures***
Generally accepted Accounting Standards • Measurement systems • Disclosures • Reporting methods	Accounting System • Accounting documents • Books of Accounts • General Ledgers and Subsidiary Ledgers • Chart of Accounts • Reporting Formats and frequency of reporting

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Financial Management Cycle

- **What is Internal Control Policy vs Systems & Procedures ?**

Policy	***Systems & Procedures***
• Adequate separation of duties • Proper authorization of transactions and activities • Adequate documents and records • Independent check on performance	• Detailed systems and procedures on transaction such as: - receipts - disbursement - non-cash transactions - loan approval - Purchase of equip't. - Others

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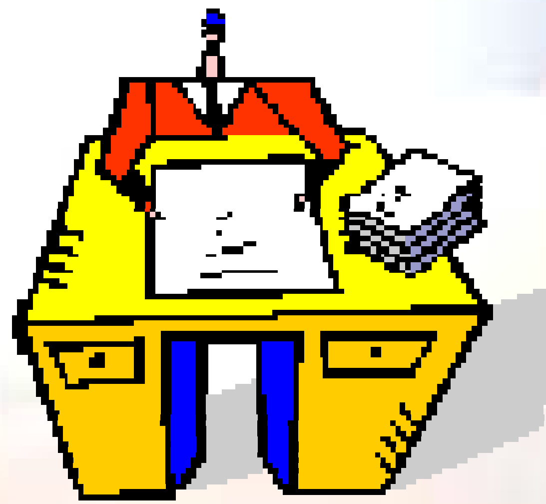
Module 5

Understand what the auditor does . . .

Auditors are not engaged by your credit union to verify the accuracy of the financial statements

It is the job of the credit union!



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Module 5

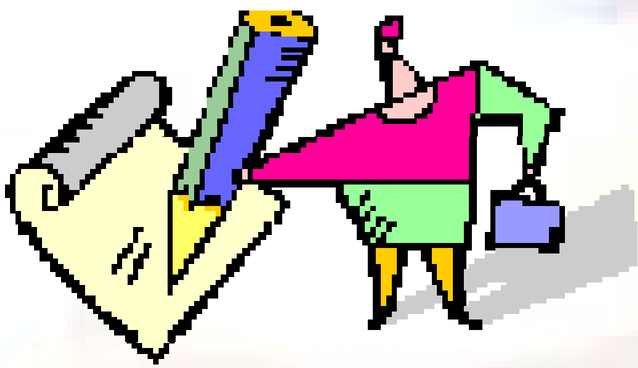
Understand what the auditor does . . .

	Credit Union	External Auditor
Report	**Financial Statements**	**Audit Report**
Function	Attestations	Express Opinion
Means of fulfilling the function	• Sufficient internal controls • Policies • Systems & procedures	Audit Evidence • **Physical examination** • **Confirmation** • **Documentation** • **Observation** • **Inquiries of the client** • **Analytical procedures**

Understand what the auditor does . . .

Audit Opinions the Auditor issues:

- Unqualified
- Qualified
- Adverse
- Disclaimer of Opinion



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Module 5

Financial Management Cycle

Documenting <u>Past</u> Performance

Income Statement
Balance Sheet
Statement of Cash Flow

Analyzing <u>Past</u> Performance

2

Ratio Analysis
Trend Analysis
Benchmarks-PEARLS, CAMEL

Predicting <u>Future</u> Performance

Cash Budget

Measuring Performance

- **Financial statements provide operating results (income, cash flow, asset status, etc.), but statements by themselves yield little decision making information.**
- **Analysis of performance yields additional information and *aids decision making.***

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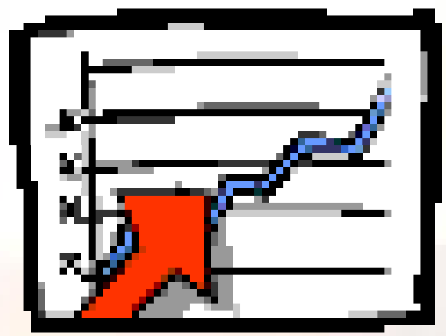
Why Ratios Are Useful?

- **Standardize numbers; facilitate comparisons**
- **Used to highlight weaknesses and strengths**
- ***Provide basis for decision making***



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Ratio Analysis

- ***Ratio analysis*** **allows managers and others to monitor performance against norms or other standards.**

- **It is an Early Warning Device, alerts the management of the danger**

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Module 5

Ratio Analysis

Effective ratio analysis requires:

A benchmark for comparing results (industry avg., budget, prior year ratios).

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Module 5

Problems and Limitations of Ratio Analysis

- **Different operating and accounting practices distort comparisons.**
- **Sometimes hard to tell if a ratio is *"good"* or *"bad."***
- **Difficult to tell whether company is, on balance, in strong or weak position.**

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Limitations of Ratio Analysis

- "Average" performance not necessarily good.
- Seasonal factors can distort ratios.
- "Window dressing" techniques can make statements and ratios look better.

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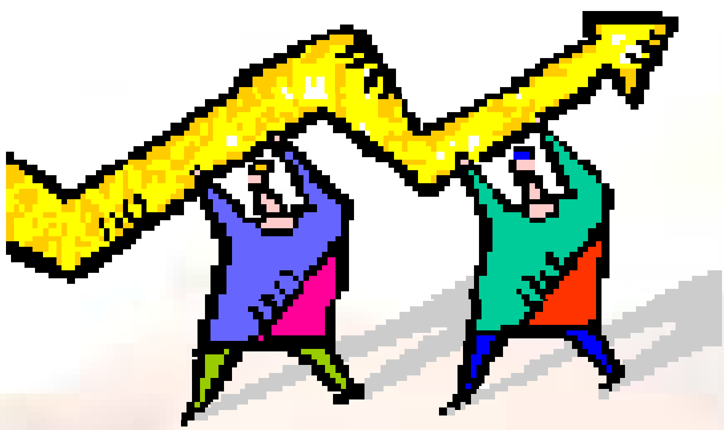
PEARLS Ratios

- Present the PEARLS Ratios (PowerPoint presentation in separate file)



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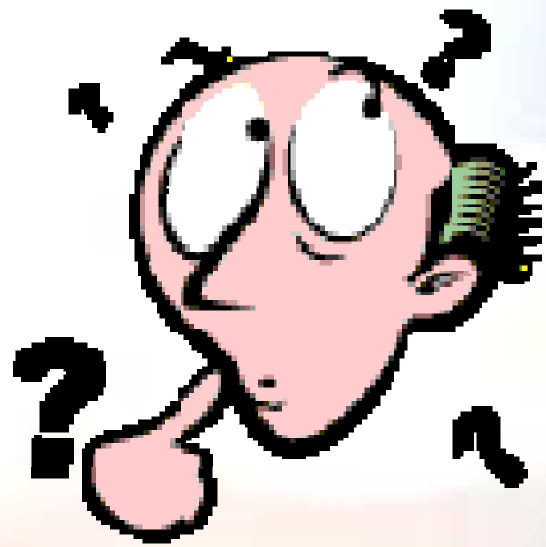
Module 5

Number Crunching with PEARLS . . .

What it actually gives you?



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Module 5

Number Crunching with PEARLS . . .

Know that your Credit union performance is up to or not up to standards . . .

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Module 5

Number Crunching with PEARLS . . .

If not, you need to put together a plan meeting the standards . . .

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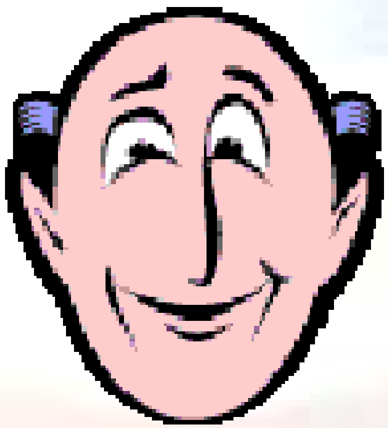
Module 5

Number Crunching with PEARLS . . .

What are those goal areas that you need to focus on?



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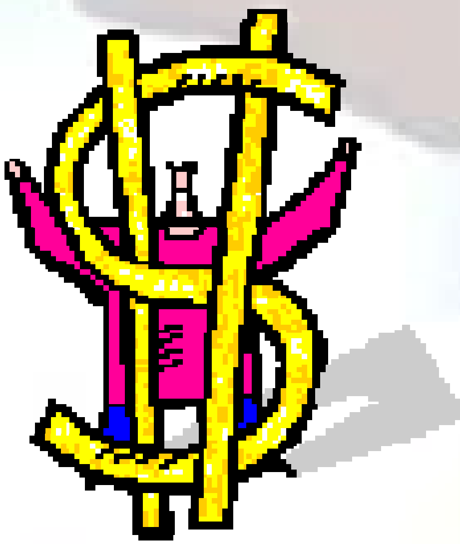
Module 5

Number Crunching with PEARLS . . .

- **Savings**
- **Membership growth**
- **Delinquency**
- **Loans**



And thus, the basis of your budgeting . . .

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Module 5

Financial Management Cycle

Documenting Past Performance

Income Statement
Balance Sheet
Statement of Cash Flow

Analyzing Past Performance

Ratio Analysis
Trend Analysis
Benchmarks-PEARLS, CAMEL

Predicting Future Performance

Cash Budget

3

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Predicting ~~Future~~ Performance

Budget

Purpose of Budget:

Control tools that can help Board and Managers analyze the difference between expected activity and actual results.

Analyzing past performance

- Analyze the ratios – review policy
- Provide guidelines for improvement
- Find out the reasons of not achieving the ratios - 2
- Study and analyze
-

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Module 5

Analyzing future performance

- Approve budget and submit to AGM
- Adjust budget based on past performance
- Business plan
- Give direction
- Develop policies
- Compare with strategic plan budget
- Give direction for ways

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Module 5

Budgeting

- BOARD & CEO Level playing field

Board:

- Develop policy on budgeting
- Set priorities on the budget based on goals
- Recommend to the General Assembly the approval of the budget
- Monitor

CEO:

- Implement the policy
- Prepare budget with assumptions based on the priorities
- Report to the Boards the Actual vs Budget with variance analysis of key numbers or accounts

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Budgeting

- **What kind of budget has to be prepared?**

The financial picture of the future…

1. Projected Income Statement
2. Projected Balance Sheet
3. Projected Statement of Cash Flow

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Module 5

Financial Management Cycle

Documenting <u>Past</u> Performance

Income Statement
Balance Sheet
Statement of Cash Flow

Analyzing <u>Past</u> Performance

Ratio Analysis
Trend Analysis
Benchmarks-PEARLS, CAMEL

Predicting <u>Future</u> Performance

Cash Budget

Thank you very much

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